Briefing Note 2: Economic implications of the 2022 MTBPS

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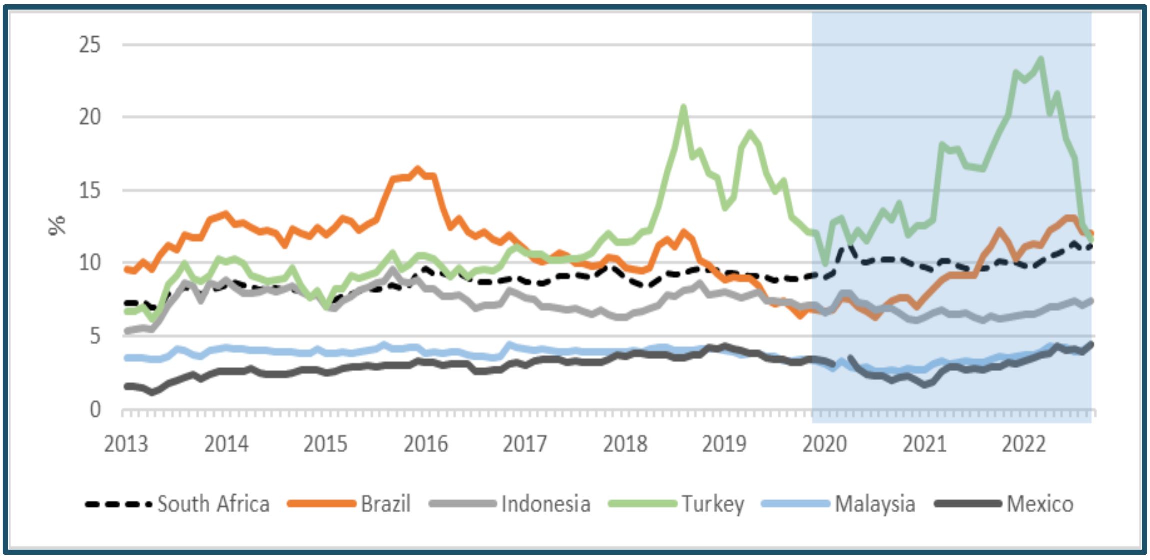
The economic shock caused by COVID-19 and policies designed to contain the pandemic induced significant fiscal responses across emerging markets, generally aimed at relief for the most vulnerable and support for affected industries. However, these were much more modest in scale than in advanced economies, and have been rolled back sooner and more aggressively due to a range of constraints. These include increasing yields on government bonds which, after a decade or so of growth in foreign debt amid historically low interest rates following the Global Financial Crisis of 2007/8, put pressure on government budgets in low- and middle-income countries and constrain policy space (Graph 1). The 2022 Medium Term Budget Policy Statement (MTBPS) indicates that government aims to follow this trend. It reaffirms National Treasury's commitment to pursuing steep budget cuts over the next few years despite the negative social and economic outcomes that the cuts are likely to produce.

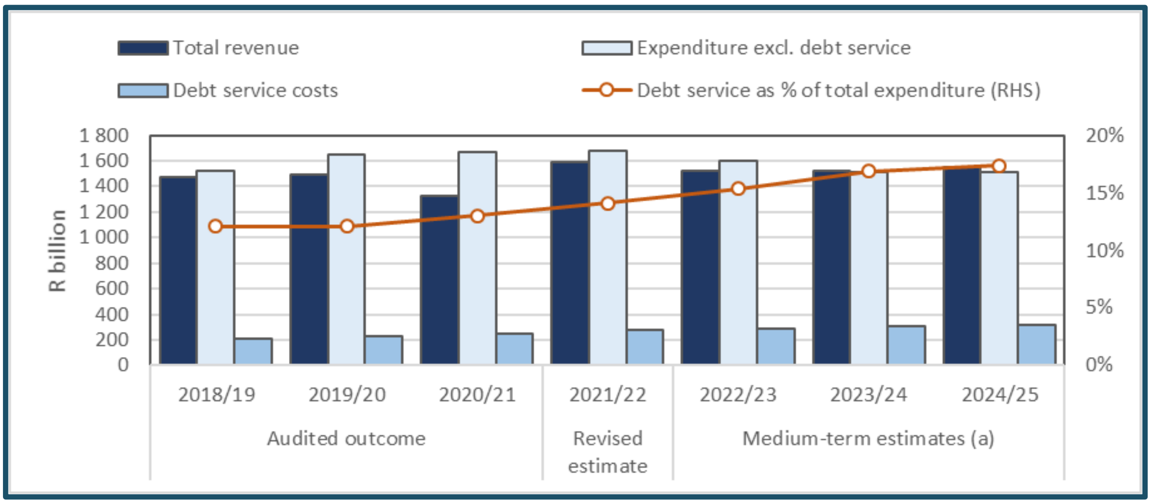
Graph 1. Yields on 10-year government bonds, South Africa vs. selected peers, 2013-2022



Source: Reuters. Time series on emerging market government bonds. Accessed via Datastream in December 2022.

Non-interest expenditure is projected to contract by 4.5% in real terms in 2022/23, and a further 5.5% in the following fiscal year before stabilising (Graph 2). Debt service costs will rise substantially over this period, up from around 12% as a share of total expenditure before the pandemic to well over 17% in the medium term; as a share of GDP, these payments to creditors will rise from 3.4% in 2018/19 to over 5% by 2024/25. The benefits from the recent commodity price spike, reflected in extraordinary profitability in the mining sector and a boost to government revenues in 2021/22, will therefore accrue largely to shareholders and creditors through dividends and interest payments rather than ordinary South Africans through government support for livelihoods and job creation.

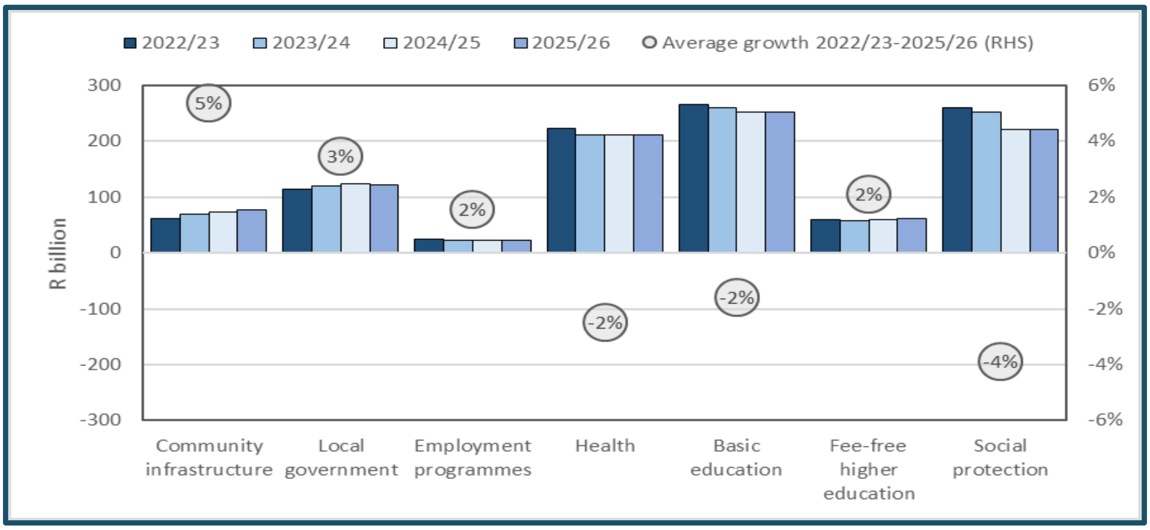
Graph 2. Planned main budget revenue, expenditure and debt service in constant rand, and debt service as a percentage of total expenditure, 2018/19 to 2024/25



Note: Deflated with CPI as estimated in budget documentation. Source: Calculated from Treasury. Budget Review 2022 and Medium Term Budget Statement 2022. Data in excel spreadsheets. Accessed at www.treasury.gov.za in November 2022.

As discussed in the [third quarter 2021 edition of the REB,](#) projected cuts are to be funded by reducing spending on some of the governing party's most important constituencies and as such are likely to face resistance. The biggest cuts are to social grants and public servants' pay. Some constituencies are more organised than others, however, so some cuts are more likely to be fully implemented than others. Graph 3 illustrates Treasury's medium-term plans for spending on key elements of the social wage, which the MTBPS describes as support for poor households. In real terms, the total social wage will contract by 2% per year on average until 2025/26. While a notable expansion in support for housing, transport and water infrastructure is provided for, this is more than offset by substantial cuts to the largest and most important programmes – health, basic education and social protection (made up mostly of social grants). Because of population growth (around 1.5% a year), the cuts will be larger in per-person terms.

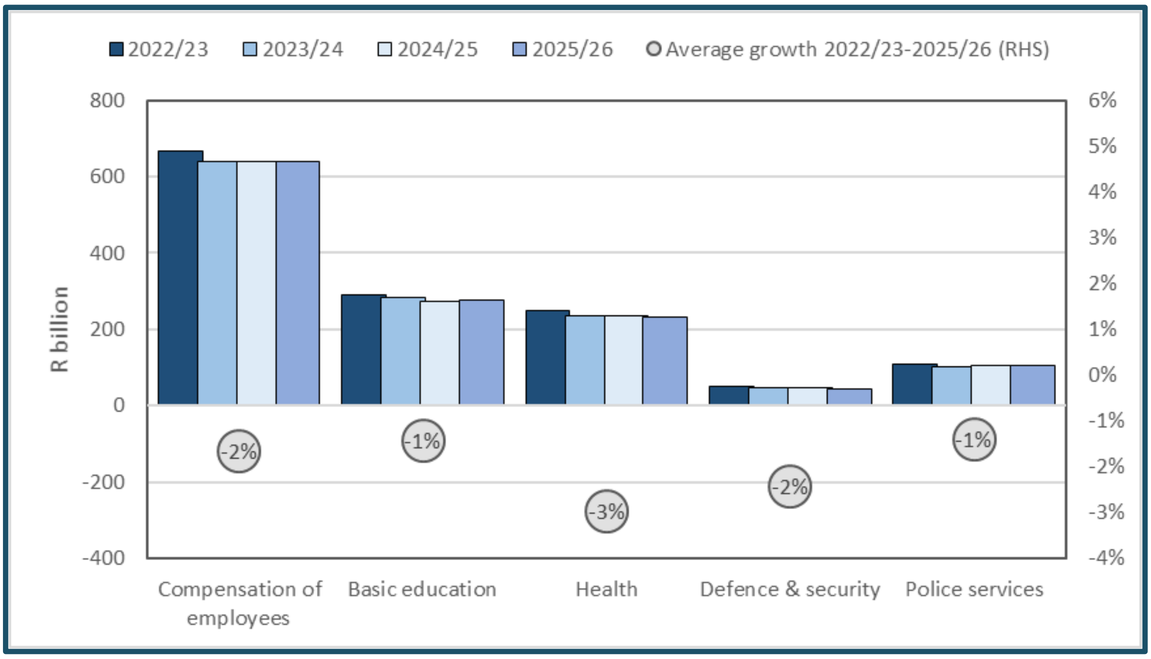
Graph 3. Spending on the social wage in the 2022 MTBPS in constant rand



Note: 2022/23 figures are revised estimates; 2023/24-2025/6 figures are medium-term estimates. Deflated with CPI as estimated in budget documentation. Source: Calculated from Treasury. Medium Term Budget Statement 2022. Data in excel spreadsheets. Accessed at www.treasury.gov.za in November 2022.

The MTBPS also plans cuts that will directly impact the black middle class. Already down significantly from 2019 levels,[1] public employees' compensation is projected to be cut 2% per year in real terms between 2022/23 and 2025/26 (Graph 4). Cuts to public sector workers' compensation are spread across key areas of service provision such as basic education, policing and health. Around two thirds of the 1.2 million state employees work in these functions. Since these departments' budgets are to be cut in general, not just in terms of compensation, it can be expected that the quality of public service provision will decline alongside salaries, thus affecting provision for the poor while reducing opportunities for stable middle class jobs in the state.

Graph 4. Spending by function in the 2022 MTBPS in constant rand



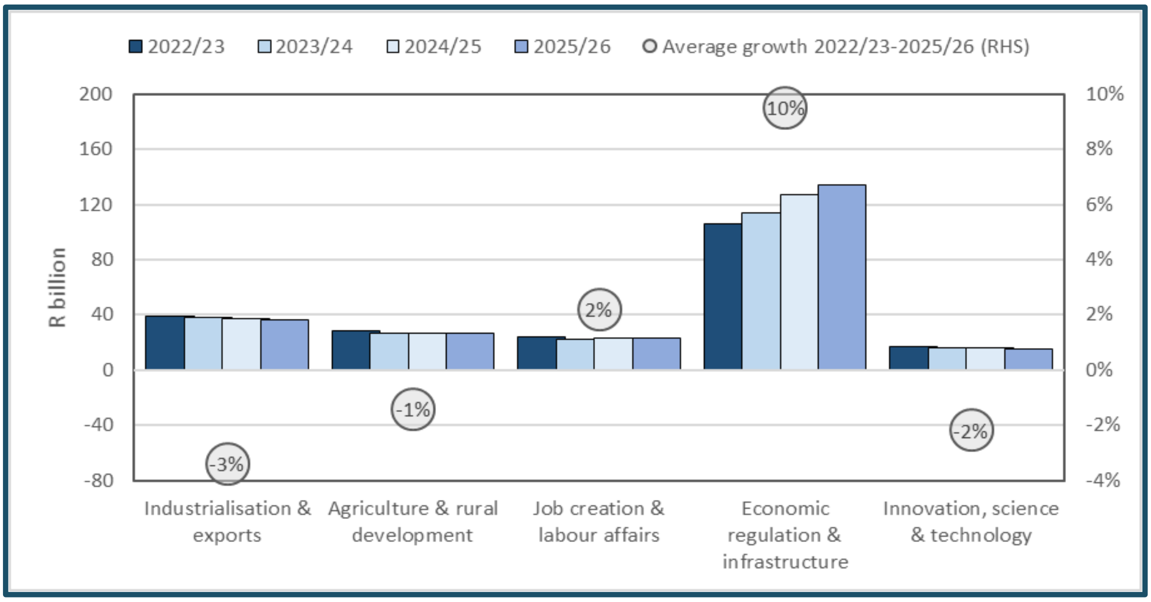
Note: 2022/23 figures are revised estimates; 2023/24-2025/6 figures are medium-term estimates. Deflated with CPI as estimated in budget documentation. Source: Calculated from Treasury. Medium Term Budget Statement 2022. Data in excel spreadsheets. Accessed at www.treasury.gov.za in November 2022.

Expenditure on economic development programmes is one of the few areas in which government spending in projected to increase in the medium term (Gra[h 5). This is driven by an average increase of 10% expenditure per annum on economic regulation and infrastructure from 2022/23-2025/26, but is partially funded by reduced spending on other key economic development programmes including industrialisation and exports (-3%), innovation, science and technology (-2%), and agriculture and rural development (-1%).

The impact of these cuts on the effectiveness of industrial policy are unclear, but appear unlikely to be positive due to the critical importance of export promotion and innovation policies for sustained and beneficial participation in global value chains. In addition, since the proposed cuts are likely to exacerbate inequality and make it harder to justify supporting private enterprises with public funds, conflict over industrial policy can be expected to increase.

[1] Makgetla, N. 2022. Budget priorities in times of stress. Business Day. Available at: https://www.business live.co.za/bd/opinion/columnists/2022-11-21-neva-makgetla-budget-priorities-in-times-of-stress/.

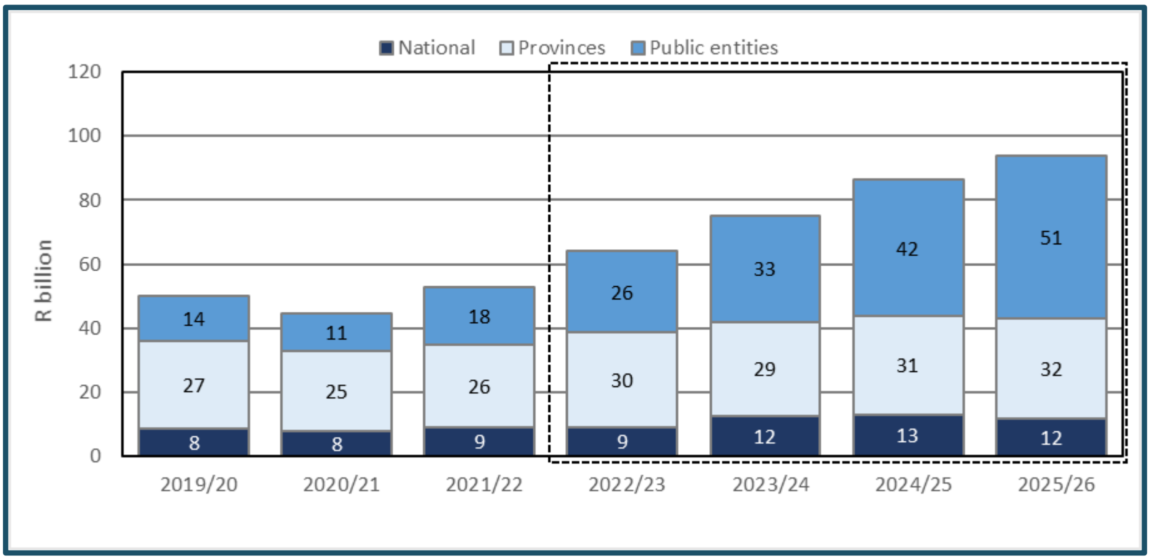
Graph 5. Spending on economic development in the 2022 MTBPS in constant rand



Note: 2022/23 figures are revised estimates; 2023/24-2025/6 figures are medium-term estimates. Deflated with CPI as estimated in budget documentation. Source: Calculated from Treasury. Medium Term Budget Statement 2022. Data in excel spreadsheets. Accessed at www.treasury.gov.za in November 2022.

For infrastructure spending, the MTBPS envisions a major role for state-owned companies (SOCs) (Graph 6). While infrastructure spending by national and provincial departments is set to increase, spending by SOCs is the overwhelming driver of growth in this area. Improved infrastructure may improve SOC performance, service delivery and enable economic growth and job creation in some areas if executed well, and incomes associated with this expenditure may offset political conflict to the extent that they benefit some important constituencies. However, as discussed, a large number of South Africans are set to see their life chances deteriorate further if the cuts envisioned in the 2022 MTBPS are implemented as planned, and so escalated levels of social conflict should be anticipated in the near future.

Graph 6. Spending on buildings and fixed structures in the 2022 MTBPS in constant rand



Note: 2019/20-2021/22 outcomes are audited outcomes; 2022/23 figures are revised estimates; 2023/24-2025/6 figures are medium-term estimates. Deflated with CPI as estimated in budget documentation. Source: Calculated from Treasury. Medium Term Budget Statement 2022. Data in excel spreadsheets. Accessed at www.treasury.gov.za in November 2022.